Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Maldonado	Analyst:	William Koch	Bill Number:	SB 137
Related Bills:	See Legislative History	Telephone:	845-4372	Amended Date:	March 31, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Interest On Overpayments Of Tax-Not Allowed If Refunded Or Credited Within 60 Days After Return Is Filed

SUMMARY

This bill would modify the period the Franchise Tax Board (FTB) is required to pay interest on Personal Income Tax (PIT) overpayments.

SUMMARY OF AMENDMENTS

The March 31, 2009, amendments deleted spot bill language and added provisions that would modify the period FTB is required to pay interest on PIT overpayments.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to compensate taxpayers whose PIT overpayment refunds are delayed longer than 60 days.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2010, and specifically operative for the 2008 taxable year and each taxable year thereafter.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

In general, current federal and state law require the Internal Revenue Service and FTB, respectively, to pay interest on PIT overpayments refunded or credited after the later of 45 days from the date the tax return is filed, or the due date of the tax return, without regard to extension.

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Under state law, the annual interest rate for PIT overpayments is the federal short-term rate, rounded to the nearest percent, plus 3 percent. The rate determined in January of each year applies during the following July through December period, and the rate determined in July of each year applies during the following January through June period. The current annual interest rate on PIT overpayments is 5 percent, compounded daily.

Existing state law authorizes state agencies the option to refrain from issuing a refund for an overpayment of $10 or less. FTB automatically issues a refund of $1 or more and will issue a refund of less than $1 on written request from a taxpayer.

The California State Controller's Office accounts for and controls the disbursement of all state funds, including tax refunds.

THIS BILL

For taxable year 2008, and each taxable year thereafter, it appears this bill would require FTB to pay interest on PIT overpayments refunded or credited more than 60 days after the date a tax return is filed. As indicated in the Federal/State Law discussion, current state law generally requires FTB to pay interest on PIT overpayments refunded or credited after the later of 45 days from the date the tax return is filed, or the due date of the tax return, without regard to extension.

Depending on the date a taxpayer files a return, this bill would require FTB to pay interest on PIT overpayments earlier or later than required under current law. For example, it appears that under this bill a calendar year taxpayer that filed a 2008 taxable year return on January 15, 2009, would be due interest if the overpayment is refunded or credited after March 16, 2009. Using the same scenario, current law would require FTB to pay interest if the overpayment is refunded or credited after May 30, 2009.

If the taxpayer in the above example filed on April 15, 2009, under this bill, it appears FTB would be required to pay interest if the overpayment is refunded or credited after June 15, 2009. Under current law, FTB would be required to pay interest if the overpayment is refunded or credited after May 30, 2009.

This bill would also declare that the interest allowed to taxpayers with respect to the 2008 taxable year serves a public purpose and does not constitute a gift of public funds.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

It appears this bill would require FTB to pay interest on PIT overpayments refunded or credited more than 60 days after the date a tax return is filed. However, it is unclear if this bill, as drafted, would provide legal authority for FTB to pay additional interest for periods prior to the original due date of a taxpayer's return. Overpayments are generally statutorily deemed to occur no earlier than the original due date of the tax return, so interest on overpayments begins no earlier than that date. Department staff is available to assist the author's office to draft amendments to resolve this uncertainty.

This bill would require FTB to pay interest on PIT overpayments earlier or later than required under current law for taxable year 2008 and each taxable year thereafter. This bill would require the department to recalculate interest on overpayments already credited or refunded for the 2008 taxable year. In some instances, depending on the enactment date of this bill, taxpayers previously allowed interest would not be entitled to that interest under the provisions of this bill. This would result in the department mailing a balance due notice to those taxpayers. If this not the author's intent, it is recommended that the bill be amended to clarify this issue.

This bill would apply to taxable year 2008 and each taxable year thereafter. Although the bill doesn't specify when the department would be required to recalculate the interest due on previously allowed credits or refunds for the 2008 taxable year, implementing this bill during tax return filing season would be problematic for the department and could disrupt the processing of tax returns.

LEGISLATIVE HISTORY

AB 1251 (Saldana, 2009/2010) would require FTB to pay interest on PIT tax refunds that are specifically delayed by the State Controller. Interest would be paid beginning 15 days after a return is filed, or 15 days after the date the issuance of refunds is postponed. This bill is currently referred to the Assembly Committee on Rules.

SB 704 (Knight, et al, 2001/2002) would have required FTB to allow simple interest on overpayments from the date of the taxpayer's payment, whether the payment was wage withholding or an estimated tax payment, to the date refunded or credited by FTB. SB 704 failed to pass out of the Senate Revenue and Taxation Committee by the constitutional deadline.

BACKGROUND

On February 2, 2009, the State Controller, due to the state's cash crisis, implemented a 30-day delay on many types of payments, including tax refunds. Over 3 million PIT tax refunds totaling in excess of $2 billion were delayed. On March 6, 2009, the State Controller announced he had begun issuing the delayed payments.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York.* These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Florida only has a corporation income tax; therefore, interest on personal income tax overpayments is not applicable.

Illinois, Massachusetts and *Minnesota* generally allow interest on PIT overpayments refunded after the later of:

- 90 days after the return's due date
- 90 days after the date the return if filed

Michigan and *New York* generally allow interest on PIT overpayments refunded after the later of:

- 45 days the return's due date
- 45 days after the date the return is filed

FISCAL IMPACT

This bill would require the department to make changes to tax return processing procedures as well as computer system programming. The additional costs have not been determined at this time. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this proposal would result in the following annual revenue gains beginning in 2008/09.

Estimated Revenue Impact of SB137 Effective for PIT Tax Years 2008 & Thereafter Enactment Assumed January 1, 2010 ($ in Millions)		
2008/09	2009/10	2010/11
+$0.46	+$1.3	+$1.6

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this bill would depend on: (1) the number of refunds issued after 60 days of the return filing date but before interest is paid under current law, (2) the number of refunds issued more than 60 days after the return due date, (3) the value of the refunds, and (4) the interest rate paid.

Based on departmental data as of April 1, 2009, approximately 41,000 PIT overpayments valued at $12.5 million for the 2008 tax year would meet this bill's criteria for receiving interest. Using the current interest rate of 5 percent per year compounded daily, the accrued interest payable would be approximately $54,000. Approximately 20,000 of the accounts accrued less than $1 of interest due to the small amount of refunds claimed. (The average refund claim between January and March 2009 was approximately $300.) As published in the PIT income tax instruction booklets, FTB does not issue a refund for less than $1 unless the taxpayer makes a written request. This reduced the $54,000 in interest to $34,000 [$54,000 – (20,000 x $1)], which would be paid in fiscal year 2009-10, accrued back to 2008-09 when incurred. This estimate assumes the state will not delay tax refunds in future years, and will issue refunds as returns are processed.

There would be a revenue gain to the General Fund by extending the time before interest is paid by 15 days for those returns filed on or after the due date. In fiscal year 2007-08, approximately $10 million in interest was paid on current year refunds over an average of 150 days. By reducing this amount by the interest rate for 15 days, it results in an interest savings of $1 million for 2008 tax year refunds. Because this bill would not become effective until January 1, 2010, it is assumed that one-half of this amount ($1 million x 50% = $500,000) would be realized from taxpayers. In future years, there would be interest savings from both current tax year and prior tax year refunds. It is estimated that each year, there would be approximately $1 million in current year interest savings plus $310,000 in interest savings for each prior year.

The 2008/09 fiscal year is $464,000, the net of the $500,000 gain in interest savings less the $34,000 additional interest paid.

LEGISLATIVE STAFF CONTACT

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